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SUBJECT: IRAQ'S DEVELOPMENT BUDGET--CHALABI'S CHART

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1.(SBU) SUMMARY: DPM Chalabi provided the Ambassador a copy of a "capital investment disbursement vs. allocated budget" bar chart written in Arabic on 27 July 2005. This chart was used to portray the point that ITG ministries have currently disbursed 20% of their total capital investments. Chalabi indicated there is potential for significant unallocated funds to offset and reduce the deficit. END SUMMARY

ANALYSIS

2.(SBU) The chart provided by DPM Chalabi to portray a potential surplus of capital investment funds was partially misleading. The chart actually portrays the percentage of Ministry of Finance (MOF) disbursed funds compared to ministry and program capital investment lines in the 2005 budget. The graph does not illustrate true value or scale of funds budgeted for each ministry or program. The graph also does not include the Ministry of Defense (MOD) or the Ministry of Interior (MOI), thus is not a true reflection of the capital investment budget. The issue that is most prominently evident from this chart is the low disbursement rate of MOF funds to the ministries and programs. The question that requires additional research is why there is this low disbursement rate and variations between ministries (e.g. Ministry of Education 100 per cent vs. Ministry of Housing 5 per cent). (NOTE: there is a slight, but not significant variation between Embassy and the ITG budget numbers. IRMO will more fully develop this analysis. END NOTE)

3.(SBU) Embassy Economic Section initial analysis using IRMO MOF data indicate that 27 per cent of the capital investment funds have been disbursed at this time. However, many ministries complain that they are requesting their capital investment and operational funds, but MOF is failing to release those requested funds. IRMO MOF consultants state that the MOF has implemented new budget processing procedures to improve transparency. Many of the ministries have yet to adapt to the more rigorous methods for requesting fund release. There are indications/rumors that the government is slowing disbursements to ensure a funding surplus, thus allowing possible re-prioritization to ministries such as MOD and MOI that are over-spent. (Note: A follow on meeting between IRMO MOF consultant, Acting ECON counselor with the MOF Chief of Staff denied that they were slowing release and that it was the failure of the ministries to make proper request for fund distribution. END NOTE)

4.(SBU) The slow formation of the government, historical last quarter spending (27% on average), and poor financial execution capacity in many ministries will likely result in some ministries being under-spent by the end of the fiscal year. In addition, the PM has added a contract review board to improve transparency on any project over \$3 million and this has also slowed disbursement rates. Assuming no deliberate slow-down of fund disbursements is occurring, it can be extrapolated that 66 per cent of the capital investment funds would be disbursed by year-end.

COMMENTS

15. (SBU) COMMENT: Chalabi's assertions are partially valid in the sense that the budgetary shortfall could be reduced at the expense of the capital investments required to sustain further economic development. This would be a poor approach to reducing the deficit, as it would slow reconstruction, economic growth, and employment generation going into the election. The failure to fully implement their capital investment programs will leave a significant shortfall in reconstruction spending and fall below the

ideal absorptive capacity of the Iraqi economy. END COMMENT

KHALILZAD